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No. 504

In the Supreme Court of the United States

October Term, 1962

ROY L. MORRIS AND ELIZABETH B. MORRIS, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

MEMORANDUM FOR THE RESPONDENT

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OPINIONS BELOW

The opinion of the Tax Court (R. 35a–41a)[1] is reported at 36 T.C. 556. The opinion of the court of appeals (Pet. 9–12) is reported at 305 F. 2d 290.

JURISDICTION

The judgment of the court of appeals was entered on June 28, 1962 (Pet. 13). A timely petition for rehearing was denied on August 15, 1962 (Pet. 14). The petition for a writ of certiorari was filed on October 11, 1962. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

[1] "R." refers to the appendix to the taxpayer's brief in the court of appeals.

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QUESTION PRESENTED

Upon the death of an officer of a corporation, the board of directors authorized the payment, out of corporate assets, of $65,000 to his widow. The question is whether the payment so authorized was a "gift" excludible from the widow's gross income under § 102(a) of the Internal Revenue Code of 1954.

STATUTE INVOLVED

Internal Revenue Code of 1954 (26 U.S.C.):

> SEC. 102. GIFTS AND INHERITANCES.
>
> (a) *General Rule.*—Gross income does not include the value of property acquired by gift, bequest, devise, or inheritance.
>
> * * * * *

STATEMENT

1. Arthur Purdy died on November 3, 1954. He was then the president, and had for 18 years been an officer, of the A. R. Purdy Company, Inc. He owned approximately 46% of the stock of the corporation; his sister and her husband owned 42%; and the remaining 12% was held in a trust for the benefit of his children and his sister. Mr. Purdy's will devised his 46% of the stock to a trust of which his widow was a co-trustee (with a corporate trustee), the life beneficiary, and the holder of a general power of appointment as to one-half. Shortly after Mr. Purdy's death, his brother-in-law succeeded him as president and Mrs. Purdy succeeded him as a director. Mr. Purdy's salary ($32,500 a year) for the period up to the date of his death was paid to his personal representative, and there was no contract,

practice, or understanding requiring the corporation to make any further payments (R. 2a, 9a–10a, 21a, 35a–37a).

On December 28, 1954, the board of directors, with Mrs. Purdy participating as a director, adopted a resolution authorizing the payment of $65,000 to Mrs. Purdy. The minutes of the meeting read in part as follows (R. 37a–38a):

> The Chairman again referred to the untimely death of the Company's President, Mr. Arthur R. Purdy, who had been associated with the Company since June 15, 1936, stating that his services to the Company had endeared him to all the officers and employees so his loss was deeply felt by all associated with the Company. In view of Mr. Purdy's long and loyal service to the Company, the officers thought that his salary should be continued to be paid to his widow, Mrs. Elizabeth Ellis Purdy, for a reasonable period of time after his death in recognition of such service.
>
> After consideration and upon motion duly made and seconded, the following preambles and resolutions were unanimously adopted:
>
> WHEREAS, Arthur R. Purdy, President of this Company, died on November 3 1954 and
>
> WHEREAS, he had been associated with the Company for more than 18 years and had rendered loyal and faithful service to the Company, and
>
> WHEREAS, the Directors believe that recognition of such service should be made and that his salary should be paid for a reasonable

period of time to his widow, Mrs. Elizabeth Ellis Purdy, now therefore be it

RESOLVED: that subject to further action of this Board, this Corporation in recognition of the services rendered to it by Arthur R. Purdy, former President of this Corporation, pay to his widow, Mrs. Elizabeth Ellis Purdy, an amount equivalent to his salary of $32,500. per annum in monthly installments of $2,708.33 each for a period of 24 months commencing November 1954 and ending with the month of October 1956.

Pursuant to that resolution, the corporation made monthly payments to Mrs. Purdy totalling $5,000 in 1954,[2] $32,727 in 1955, and $27,273 in 1956. The corporation recorded the payments on its books under the caption "Employees' Death Benefits"; deducted them on its income tax returns as business expenses; and withheld income and employment taxes from them until Mrs. Purdy and her attorney complained and undertook to hold the corporation harmless for a failure to withhold. Mrs. Purdy treated the payments as "gifts" excludible from income under § 102(a) of the Internal Revenue Code of 1954 and did not report them as income. The Commissioner held that the payments were not gifts and determined deficiencies for 1955 and 1956 accordingly. In due course, the taxpayers (Mrs. Purdy, now Mrs. Martin, and her husband, with whom she had filed joint returns) petitioned

[2] The $5,000 paid to Mrs. Purdy in 1954 was admittedly excludible from income as an employee death benefit under § 101 (b) of the 1954 Code and is accordingly not in issue. Of that amount, $2,500 was actually paid to Mrs. Purdy on November 8, 1954, prior to but in anticipation of the resolution (R. 36a).

the Tax Court for a redetermination of the deficiencies. (R. 38a–39a.)

2. In addition to the above facts, the only material evidence offered at the trial was the testimony of two of the directors who had voted for the resolution. John Eiseman, an officer of a bank which made loans to the company, testified that the only discussion at the directors' meeting that he recalled was his asking whether the payments would be deductible by the corporation and being told that they would be (R. 8a). This colloquy followed (R. 8a–10a):

> Q. In voting in favor of the resolution, what did you intend, you personally, to achieve?
>
> A. A continuation of income for Mrs. Purdy for a period as far as I knew would be allowed the company as a tax deduction.
>
> Q. Did you have any concern whatsoever for Mrs. Purdy in making and arriving at your decision?
>
> A. I would certainly be concerned about Mrs. Purdy's financial future, as an individual—yes, I was, sir.
>
> Q. As an individual?
>
> A. Yes.
>
> Q. How about as a director?
>
> A. As a director of the company and as a representative of the bank, I was primarily concerned with the financial status of the company itself. I had been asked to come on the Board primarily to represent the interests of the bank.
>
> Q. * * * were you of the opinion at the time you voted in favor of it, that this was a gratui-

tous favor, out of corporate generosity to Mrs. Purdy?

* * * * *

A. I should like you to enlarge on your definition of a gratuity payment.

Q. One not made pursuant to any prior contract, plan, or any other obligation of the corporation.

A. I should certainly say that I did not have in mind that there was any contract or obligation on the part of the company in my mind. I supported the fact in my own thinking that the services that the late Mr. Purdy had rendered to the company justified the payment on its part.

* * * * *

Q. * * * [Does your last statement mean] that you would not have voted in favor of such payments to Mrs. Purdy, had her husband been someone * * * who had not performed such loyal and faithful service to the company?

A. I think that is correct.

On cross-examination by government counsel, Mr. Eiseman reiterated that his "primary concern" was with the "financial health" of the corporation and that was why knowing whether the payments would be deductible was important to his decision (R. 13a). On re-direct examination, the witness stated that he had known that Mr. Purdy's estate consisted largely of the company's stock; that he knew that the company had not in recent years paid dividends;[3] and that he knew that Mr. Purdy's death would thus cut

[3] The corporation had an earned surplus of over $800,000 (R. 39a).

off Mrs. Purdy's main source of income. Asked whether that was "an influencing factor" in his voting for the resolution, he replied (R. 17a–18a):

> A. I would say it had a bearing on it, yes, sir.
>
> Q. Did it have a material bearing?
>
> A. Yes, sir, I would say it would.

The other director who testified was Mr. Purdy's brother-in-law, Ralph W. Shaw, who had succeeded Mr. Purdy as president of the corporation. As a witness for the taxpayers, he testified that there was no plan or understanding calling for a continuation of Mr. Purdy's salary to his widow and that the fact that Mr. Purdy had been a large stockholder had not influenced him in voting for the resolution (R. 21a–22a). Then (R. 22a):

> Q. * * * Was your action in any way materially influenced by your knowledge of the fact that the deceased officer was your wife's brother?
>
> * * * * *
>
> A. I would say it would have some influence, but not material.
>
> Q. In other words, that was not a factor which tipped the scales one way or another, in your opinion in arriving at a decision?
>
> A. No, sir, it was based upon the past services of Mr. Purdy.

Recalled as a witness for the government, Mr. Shaw testified that he had not been "intimately acquainted with her [Mrs. Purdy's] financial condition" (R. 28a) or the size of Mr. Purdy's estate; that he had known that Mrs. Purdy was in need of cash in the days immediately following Mr. Purdy's death and

before she could get an order releasing funds from joint bank accounts; and that it was because of that need that he had authorized an advance of $2500 to her in anticipation of action by the board of directors (R. 28a–31a). The witness also recited two other occasions—both subsequent to Mr. Purdy's death—on which the company had made voluntary payments to widows of employees (R. 31a–33a). Noting that the payments to the widow in one case were at less than the employee's full salary rate, the witness explained that "the situation was considerably different" in that case because the employee "had only been working for us again about three or four years" (R. 32a).

3. The Tax Court denied that the payments "sprang from generosity or that a reason for the payments was affection, respect, admiration, charity or a like impulse"; found that they were prompted instead by "appreciation" for Mr. Purdy's services; and accordingly held that they were not gifts (R. 40a–41a).[4] The court of appeals affirmed. It stated as its holding that the Tax Court's finding was not "clearly erroneous" (Pet. 10); recited the facts in detail (Pet. 10–12); and concluded that "The clear force of these facts is that the payments were made by the corporation as additional compensation for the deceased's services" (Pet. 12).

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[4] The court's opinion actually speaks only of the "tenor" of the resolution and of the failure of the testimony to indicate otherwise, with the conclusion being cast in terms of the taxpayers not having "shown" that the payments were gifts. However, recognition of the taxpayers' burden of proof makes those negative observations the equivalent of affirmative findings.

ARGUMENT

As stated in the government's petitions for certiorari in *Commissioner* v. *Kuntz* and *Commissioner* v. *Olsen*, Nos. 394 and 395, this Term, we agree with the petitioners that the decision in this case, although in our view correct, is in direct conflict with the decisions of the Sixth and Eight Circuits in those cases. We also agree, as there stated, that the question is important. Accordingly, we join the petitioners in urging that the petition for certiorari be granted.

Respectfully submitted.

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